SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 867

NATHAN HERZOG AND EMANUEL HERZOG, INDIVIDUALLY AND AS CO-PARTNERS, TRADING AS COLUMBIA PICKLE WORKS, BANKRUPTS,

Petitioners,

vs.

JACK DORMAN,

Trustee.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Statement.

The facts are set forth in the petition, ante, pages 2-5.

As appears from the petition, a majority of the Circuit Court of Appeals, disagreeing with the District Court, denied petitioners' discharge in bankruptcy. Circuit Judge Clark in a vigorous dissenting opinion pointed out how inconsistent the majority opinion was with prior decisions of that Court and reasserted what we believe to be the established law in cases of this kind.

Summary of Argument.

Authoritative decisions overwhelmingly sustain and apply the principle of law contended for by petitioners and by Circuit Judge Clark in his dissenting opinion, namely, that the books and records maintained by petitioners met the requirements of the Bankruptcy Act.

The decision of the majority of the Circuit Court of Appeals in this case stands practically alone and is in sharp conflict with decisions of other Circuit Courts of Appeals and with prior decisions of that Court.

Point I.

The books and records maintained by petitioners met all the requirements of the Bankruptcy Act.

Upon the formation of the corporation, a full and complete set of books was opened and from that time on only one entity conducted business, to wit, the corporation. Those books were regularly audited by a certified public accountant. True it is that some bills and checks were issued to the partnership but regardless of that, every business transaction was entered in the regular books of account. Surely, investigation could easily determine whether or not petitioners had become personally liable because of such bills and checks. It is not contended that the books did not truly reflect the entire business history of both the partnership and the corporation. The narrow construction contended for by the Trustee is that the books alone, without investigation, do not disclose which are corporate creditors or partnership creditors (R. 74-6).

We submit that no such limitation may be placed upon the books. It is sufficient, if the books and records maintained are such that the financial condition and business transactions of the bankrupts might be ascertained therefrom. No formal books of account need be kept,

Anderson v. *Haddonfield National Bank*, 94 F. (2d) 721, (C. C. A. 3);

nor does the statute require or exact any particular form of books,

Hedges v. *Bushnell*, 106 F. (2d) 979 (C. C. A. 10);

nor is it necessary that books as such be kept, for the statutory requirement is in the alternative, books or records,

International Shoe Co. v. *Lewine*, 68 F. (2d) 517 (C. C. A. 5).

The rule laid down by the majority of the Circuit Court is that books must be kept in such a manner that from a mere examination thereof one can tell "whether the liability to a particular creditor is a debt of the partners or of the corporation, or whether an account receivable is a partnership or corporate asset" (R. 135). Such a construction is entirely too narrow and conflicts with a long line of authorities in other circuits. It stands practically alone, for the true rule seems to be exactly to the contrary.

> "The transactions need not be stated in full detail if they are so identified that inquiry can be made about them."
>
> *International Shoe Co. v. Lewine, supra,* at p. 518 (C. C. A. 5).

> "An impeccable system of bookkeeping which would meet with the approval of a skilled accountant or records so complete that they would satisfy an expert in business is not required as a prerequisite to discharge * * * It is enough if they sufficiently identify the transactions that intelligent inquiry can be made respecting them."
>
> *Hedges v. Bushnell, supra, at p. 982* (C. C. A. 10).

Indeed, here the bankrupts are being penalized not for a failure to keep books but rather for a failure to draw legal

conclusions which, as Judge Clark says in his dissenting opinion, "the bankruptcy court must—and I believe rather easily can—draw from the facts herein when it settles the bankrupt estate" (R. 137).

Point II.

The right to a discharge in bankruptcy is addressed to the discretion of the District Court and its action should not be disturbed unless it has abused that discretion.

There seems to be no rule of law more firmly established than that an appellate court will not disturb the action of a District Court in questions of discharge unless the District Court has committed a gross abuse of discretion.

Nix v. *Sternberg,* 38 F. (2d) 611 (C. C. A. 8);

Baash-Ross Tool Co. v. *Stephens,* 73 F. (2d) 902 (C. C. A. 9);

Third National Bank v. *Schatten,* 81 F. (2d) 538 (C. C. A. 6);

Hultman v. *Tevis,* 82 F. (2d) 940 (C. C. A. 9);

Texas National Bank of Beaumont v. *Edson,* 100 F. (2d) 789 (C. C. A. 5).

However, the court below seems to have disregarded that rule and to have substituted its own judgment for that of the District Court. Surely, it cannot be maintained in this case that the District Court abused its discretion, for there is no question whatsoever concerning the honesty of petitioners. What they did was done openly, honestly and candidly without any design to hide from creditors any transaction of any kind. There were complete books of account with every business transaction entered in them. If, after examining all the facts and circumstances the District Court was of the opinion that discharge should be granted,

its determination should not be disturbed by the appellate court. In the determination of the question whether a bankrupt's failure to keep books is justified,

> "it is evident that Congress intended that the district court should exercise a wide discretion.
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> * * * * * * *
>
> "The case is one in which the court was required to exercise the broad discretionary power vested in it. Having done so, its action should not be disturbed on appeal."
>
> *Texas National Bank of Beaumont v. Edson, supra, at p. 791.*

> "The statute lodges in the bankruptcy court a reasonably wide judicial discretion in determining whether the failure to keep or preserve books of account or records was justified under all the circumstances of the case, and ordinarily the determination of the question will not be disturbed on appeal except in case of gross abuse of such discretion."
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> *Hedges v. Bushnell, supra,* at p. 982.

Point III.

The honesty of petitioners being conceded, they were entitled to discharge.

While it is no longer necessary to show that the failure to keep books was with intent to conceal the financial condition and business transactions of the bankrupt, yet before discharge will be denied it is necessary that there be a showing of some design to cover up or conceal information, the furnishing of which would disclose assets.

In this case the court below has found that all transactions were entered in the corporate books, but it says that honesty alone is not enough to excuse petitioners. Such

a holding seems to be in direct conflict with a prior decision of the same court where it held:

> "A discharge is a privilege accorded to bankrupts by the statute unless they are chargeable with conduct showing some lack of personal business morality."
> *In re Lovich*, 117 F. (2d) 612, 615 (C. C. A. 2).

We cannot understand how petitioners' discharge can be denied when it is conceded that they were honest. If they were honest in their dealings, then they cannot be charged with a lack of "personal business morality." Indeed the decision of the majority here seems inconsistent with its decision in the *Lovich* case.

Again, as pointed out in the dissenting opinion of Judge Clark (R. 137), the protection offered by the court below to other bankrupts has been denied these petitioners.

See:

In re Marcus, 203 F. 29 (C. C. A. 2);
In re Livermore, 96 F. (2d) 93 (C. C. A. 2).

LAST POINT.

The petition for writ of certiorari should be granted.

Respectfully submitted,

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January 8, 1942.